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IN THE

Supreme Court of the United States

OCTOBER TERM—1943

No. 1036 101

C. E. GROESBECK, C. V. GRAHAM, O. L. JOHNSTON, G. N. TIDD, E. P. SUMMERSON, H. L. ALLER, J. R. HOBBINS, ELECTRIC BOND AND SHARE COMPANY and EBASCO SERVICES INCORPORATED,

Petitioners,

and

S. R. INCH, A. S. GRENIER, C. F. KELLEY, S. A. MITCHELL, P. B. SAWYER, E. B. TRACY, H. T. WHITE, W. R. KENAN, W. V. GRIFFIN, L. H. PARKHURST, W. D. THORNTON, E. ERICSON, F. R. BAUER, J. W. FROST, D. W. JACK, NEBRASKA POWER COMPANY, NEW MEXICO ELECTRIC SERVICE COMPANY, NORTHERN POWER COMPANY, NORTHWESTERN ELECTRIC COMPANY, PACIFIC POWER & LIGHT COMPANY, INLAND POWER & LIGHT COMPANY, PORTLAND GAS & COKE COMPANY, SUPERIOR WATER, LIGHT AND POWER COMPANY, TEXAS ELECTRIC SERVICE COMPANY, TEXAS POWER & LIGHT COMPANY, TEXAS PUBLIC UTILITIES CORPORATION, THE WASHINGTON WATER POWER COMPANY, AMERICAN POWER & LIGHT COMPANY, CENTRAL ARIZONA LIGHT AND POWER COMPANY, FLORIDA POWER & LIGHT COMPANY, KANSAS GAS AND ELECTRIC COMPANY and THE MINNESOTA POWER COMPANY,

Defendants,

v.

DORA GOLDSTEIN,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

JOHN F. MACLANE,
LOUIS CONNICK,
WHITNEY NORTH SEYMOUR,
Counsel for Petitioners.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioners, C. E. Groesbeck, C. V. Graham, O. L. Johnston, G. N. Tidd, E. P. Summerson, H. L. Aller, J. R. Hobbins, Electric Bond and Share Company and Ebasco Services Incorporated, respectfully pray that a writ of cer-

tiorari be issued to review the decree of the United States Circuit Court of Appeals for the Second Circuit, entered in the above cause on April 7, 1944, pursuant to decision of that Court rendered on the same date, reversing and remanding judgments of the United States District Court for the Southern District of New York which dismissed the complaint of the respondent Dora Goldstein against the petitioners and others.

Opinions Below

The orders and judgments of the District Court dismissing the complaint were filed July 15, 1942 (R. pp. 83-88). There was no opinion.

The opinion of the Circuit Court of Appeals (R. pp. 104-112) has not yet been officially reported.

Jurisdiction

The opinion of the Circuit Court of Appeals was filed April 7, 1944 (R. pp. 104-112). Rehearing was denied April 27, 1944 (R. pp. 112, 113). The decree of the Circuit Court of Appeals sought to be reviewed was entered May 13, 1944 (R. p. 114). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended (28 U. S. C. A. § 347(a)).

Statute Involved

The statute involved is the Public Utility Holding Company Act of 1935, and specifically Sections 4(a)(2), 20(d), 26(b) and 27(a) (15 U. S. C. A. §§ 79d(a)(2), 79t(d), 79z(b) and 79z-1(a)). For the convenience of this Court, these sections are set out at the end of the appendix.

Questions Presented

1. This petition presents fundamentally the question of the integrity of the stipulation between the Government, represented by the Attorney General, the Postmaster General and the Securities and Exchange Commission, and Electric Bond and Share Company and subsidiaries of that Company, upon which, as the test case, the constitutionality of the registration provisions of the Public Utility Holding Company Act of 1935 was tried and determined, resulting in the decision and judgment of this Court in *Electric Bond and Share Company, et al.* v. *Securities and Exchange Commission,* 303 U. S. 419, March 28, 1938. As will be hereinafter shown, all officers of the Government concerned with the enforcement of the Public Utility Holding Company Act extended immunity from the enforcement of civil or criminal penalties thereby imposed for any acts in contravention thereof done pending determination of the constitutionality of the registration provisions in this case. The stipulation formally embraced the covenant of immunity and the parties and the Courts before which the case was tried accepted it as such. The decree of the Circuit Court of Appeals here sought to be reviewed effectively breaches that covenant by sustaining the most drastic penalty of the Act, the virtual avoidance of all business contracts made or carried out by the parties in reliance on that covenant during the pendency of the litigation.

2. Where a company, in the course of resisting, on constitutional grounds, a suit by the Government to enforce a statute, enters into a stipulation of the character above described with the Government enforcement authorities and conducts its business as usual in accordance with the intent of such stipulation for the purpose of testing the

statute, may a stockholder of that company repudiate the action of the company in making the stipulation, and, in contravention of the findings on which the judgment of the court in such case is predicated and sustained, enforce against other parties to such suit statutory penalties imposed for so conducting its business, to wit, the avoidance of contracts lawful except for the statute, and the recovery of all moneys paid thereunder?

3. Does the doctrine of *Ex Parte Young*, 209 U. S. 123 (1908), protect a litigant, who in good faith challenges the constitutionality of a statute, against the imposition of destructive civil penalties pending determination of the constitutionality of the statute, so as to preclude a Court in a subsequent proceeding by or on behalf of one of the parties to the test suit from enforcing such penalties?

4. Does Section 26(b) of the Public Utility Holding Company Act, which declares void contracts, the performance of which involves the violation of any provision thereof, apply to violations of Section 4(a) of the Act, which this Court has held to be purely penal in its nature, where the Government officers and agencies entrusted by Section 18 thereof with its enforcement have formally agreed not to enforce such penalties pending determination of the constitutionality of the statute, particularly in view of the provision of Section 20(d) (15 U. S. C. A. § 79t(d)) of the Act that no provision thereof imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation or order of the Securities and Exchange Commission?

5. Do the provisions of Section 4(a) of the Act, which prohibit an unregistered holding company from "directly

or indirectly" using the mails or instrumentalities of commerce for performing service contracts, prohibit the performance of such contracts by a subsidiary organized for the purpose, in view of the background of the Act and the textual distinctions drawn therein between acts prohibited to holding companies and acts prohibited to their subsidiaries?

Statement

This action was instituted in the District Court for the Southern District of New York by a stockholder of American Power & Light Company to recover judgment against the defendants Electric Bond and Share Company and Ebasco Services Incorporated, and former and present directors of American Power & Light Company, for service fees paid by subsidiary operating public utility companies of American Power & Light Company to Ebasco Services Incorporated, a service subsidiary of Electric Bond and Share Company, for the period from December 1, 1935, when the registration provisions of the Public Utility Holding Company Act became effective, to April 1, 1938, when Electric Bond and Share Company and American Power & Light Company registered as holding companies under said Act, on the ground that the performance of said services was prohibited by Section 4(a)(2) of the Act and contracts therefor were rendered void by Section 26(b). This was the period during which Electric Bond and Share Company and its associated holding companies were challenging the constitutionality of the Act in a test suit for enforcement brought by the Securities and Exchange Commission. This suit resulted in the decision of this Court sustaining the constitutionality of the registration provisions of the Act. *Electric Bond and Share Company* v. *Securities and Exchange Commission, supra.*

The cause of action above described is the First cause of action in plaintiff's complaint (R. pp. 6-18). The Second and Third causes of action (R. pp. 19-23) were dismissed by separate stipulations (R. pp. 82, 101).

Certain corporate and individual defendants moved to dismiss the action on the ground of improper venue as to them and the motion was sustained (R. pp. 66-73). Thereupon the present petitioners moved for dismissal on the ground both that the complaint failed to state a claim upon which relief could be granted, and because of the absence of indispensable parties, including those corporations as to which the action had been previously dismissed (R. pp. 83-86). These motions were sustained and judgments of dismissal were entered (R. pp. 83-88). By the Court's opinion, however, it appears that the motions were granted solely because of the absence of indispensable parties without passing upon the sufficiency of the complaint upon its merits (R. p. 89).

Appeal was taken to the Circuit Court of Appeals for the Second Circuit and the judgments were reversed and the cause remanded (R. p. 114). From the opinion of that Court, it appears that it sustained the venue in the Southern District of New York and also expressly sustained the complaint as sufficient "to state a claim or claims for relief in the right of the operating companies" (R. pp. 104-112). In so doing the Court made what was in substance a dispositive order, in effect holding the petitioning defendants liable as a matter of law, on the complaint and despite the stipulation and record in *Electric Bond and Share Company* v. *Securities and Exchange Commission, supra,* leaving only the amount of liability to be determined upon accounting (R. p. 110).

This petition seeks a review only of the portion of the decision of the Circuit Court of Appeals which deals with

the sufficiency of the complaint, and invokes in support hereof the record in *Electric Bond and Share Company* v. *Securities and Exchange Commission, supra,* as well as the provisions of the statute. The Circuit Court of Appeals properly took judicial notice of this record as part of its records in another suit involving the same substantial parties. *National Fire Insurance Company* v. *Thompson,* 281 U. S. 331, 336 (1930).

Since the record in *Electric Bond and Share Company* v. *Securities and Exchange Commission, supra,* is also a part of the records of this Court and the essential facts, other than those pertaining to the portions of the stipulation and excerpts from the record bearing on its construction, are summarized in this Court's opinion in that case, we will but briefly state the facts bearing on the questions here presented without further reference than to this Court's opinion, supplemented, however, by an abstract of such portions of the record in the above mentioned case as bear specifically upon the questions presented. For the convenience of the Court we attach this abstract as an Appendix hereto, and hereafter reference to that record will be to pages of the Appendix, thus distinguishing from the record in the instant case.

Electric Bond and Share Company is one of the major public utility holding companies of the country. It has three principal public utility holding company subsidiaries in the United States, American Power & Light Company, of which plaintiff is a stockholder, Electric Power & Light Corporation and National Power & Light Company. A fourth company, American Gas and Electric Company, is also classed as a subsidiary, but its relationships are different and it is in no way involved in the present problem.

Electric Bond and Share Company owns varying percentages of the voting stock of these subholding companies;

in the case of American, it owns approximately 20%. Each of these subholding companies owns substantial majorities, in some cases approximately all, of the voting stock of public utility operating subsidiaries.

In addition to this stock ownership, Electric Bond and Share Company performed, until November, 1935, extensive services to these operating public utilities for stated fees.

Following the approval of the Public Utility Holding Company Act on August 26, 1935, and prior to the effective date of the registration provisions on December 1, 1935, Bond and Share effected an internal reorganization of its system, including the creation of a wholly owned subsidiary, Ebasco Services Incorporated, to perform the service functions for operating public utilities formerly rendered by Bond and Share itself.

This will be referred to later. It is sufficient to state here that by Section 4(a) of the Act it is made unlawful for unregistered holding companies, directly or indirectly, to transact any of their normal functions which involve the use of the mails or instrumentalities of commerce and specifically to negotiate, make or perform "any service, sales or construction contracts."

It is part of the legal history of these times that grave doubts existed as to the constitutionality of the Public Utility Holding Company Act and that some forty-eight suits were brought in various District Courts of the United States by different holding companies to test the validity of that Act (see Note, 50 Harvard L. Rev. 655 (1937)). One of these, *In re American States Public Service Co.*, 12 F. Supp. 667, prior to December 1, 1935, had resulted in a broad decision of unconstitutionality by a District Court. This decision was later affirmed by the Fourth Circuit Court of Appeals in *Burco, Inc.* v. *Whitworth*, 81 F. (2d) 721

(C. C. A. 4th, 1936), the decision, however, being qualified by eliminating the blanket declaration of unconstitutionality.

Confronted by this situation the Securities and Exchange Commission, which was entrusted by the Act with the primary duty of its enforcement, the Attorney General, and the Postmaster General, all made public pronouncements that penalties of the Act would not be enforced against non-conforming companies until and unless the constitutionality of its registration provisions was sustained and that a suit would be promptly brought to adjudicate that question. Accordingly, on November 26, 1935, prior to the effective date of the registration provisions of the Act, the Securities and Exchange Commission brought suit to enjoin Electric Bond and Share Company, American Power & Light Company and other subsidiary holding companies in the Electric Bond and Share system, from violating the provisions of Section 4(a) of the Act, and thus to compel registration as required by Section 5 of the Act.

The defendants filed a cross-bill seeking to challenge the constitutionality of the entire Act, bringing in as parties the individual members of the Commission, the Attorney General and Postmaster General, and asking for both temporary and permanent injunction against enforcement of the Act and the penalties imposed thereby.

In order to expedite the proceedings and avoid the delay and expense incident to the taking of evidence at a formal trial, a stipulation was entered into by the Securities and Exchange Commission and cross-defendants and the defendant Companies containing an exhaustive description of the history, relationship and activities of the Companies so as to demonstrate against a full and adequate factual background the impact of the Act upon what was deemed to be

a typical public utility holding company situation. By this stipulation it was agreed that neither the Attorney General, the Postmaster General nor the Commission, respectively, had instituted or would institute civil or criminal proceedings against the defendants until the constitutionality of Sections 4(a) and 5 of the Act had been determined, and that if such sections were determined to be constitutional no civil or criminal proceedings for prior violations of the Act would be had. The full text of the public announcements by the Attorney General, Postmaster General and Commission, and of the pertinent paragraphs of the stipulation, are included in the Appendix (Appendix, pp. 28-39).

Placing full faith in and reliance upon these declarations and the stipulation the defendants, including Electric Bond and Share Company, Ebasco Services Incorporated and American Power & Light Company, continued the conduct of their business pending the outcome of the case. Reciprocally, defendants refrained from instituting a multiplicity of suits, securing preliminary injunctions or otherwise creating procedural embarrassments (see p. 15, *infra*).

In their briefs and arguments before the District Court, the Circuit Court of Appeals and the Supreme Court, the Government, through its counsel, took the position that the defendants were immune from the consequences, including those imposed by Section 26, of violations of the Act until final determination by the Supreme Court (Appendix, p. 50). As conclusive illustration it is sufficient to quote here the express statement from the brief in this Court, signed by the Attorney General, the Solicitor General, counsel to the Securities and Exchange Commission and special assistants to the Attorney General, the latter by the way being the draftsmen of the Act, as follows:

> "If defendants believe that the registration provisions of the Act are unconstitutional, it is their

> privilege—and they have exercised it—to refrain from voluntary compliance. By their decision defendants have made it possible for themselves and their subsidiaries to sell securities, to acquire securities and utility assets, *to perform service, sales, and construction contracts,* to make 'up-stream loans,' to engage in other intra-system transactions, and to keep their accounts in any manner which they see fit without running afoul of the provisions of sections 6 to 15, and without fear of the taint of illegality which section 26 might otherwise cast upon such transactions." (Brief for Respondents, pp. 208-209. Emphasis supplied.) (Appendix, p. 50.)

Confirming this position of counsel, the District Court made findings as follows (Appendix, pp. 43, 44):

> "64. Other than Sections 4(a) and 5(a), the provisions of the Act (with minor exceptions not material to this cause) apply only to registered holding companies and their subsidiary companies. Each defendant is a non-registered holding company, and as such, no provision of the Act, other than the provisions of Sections 4 and 5(a) of the Act, is applicable, can be applied, or has been threatened by the plaintiff or any cross-defendant or any other officer or agency of the United States, to be applied, to any of them.
>
> 66. * * * Until the provisions of the Act other than Sections 4(a) and 5 become applicable to the defendants, neither they nor their subsidiary companies show any irreparable or substantial injury, impending or threatened."

The injunction decree was limited to violations of Sections 4(a) and 5 of the Act and was made effective thirty days after the date of the decree until registration, but its effectiveness was postponed in the event of appeal until thirty days after the filing of the mandate of the appellate court in the District Court.

As will be seen from reference to quotations from the record in the Appendix, the cross-bill filed by the defendants in this action sought to bring into question the constitutionality of the whole Act, with particular reference, among other sections, to Section 26(b), and prayed for injunction, both temporary and permanent, restraining their enforcement. The District Court, in disposing of the cross-bill and ordering its dismissal, distinctly held that sections of the Act subsequent to Section 5 were not applicable to unregistered companies and that the stipulation granted adequate protection by injunction against loss or damage which the defendants might sustain prior to the decision of the Supreme Court (Appendix, p. 48).

The decision of the District Court was sustained in every particular by the Circuit Court of Appeals and the Supreme Court. The Supreme Court expressly held Sections 4(a) and 5 to be completely separable from the remainder of the Act, and sustained Section 4(a) purely as a penal provision to compel compliance with Section 5. The Court said (pp. 442, 443 of 303 U. S.):

> "Section 4(a) prescribes the penalty for failure to register under § 5, and that section as an incident to registration imposes the duty to file the described registration statement. Treating the requirements of §§ 4(a) and 5 as a separable part of the Act, the question is whether that penalty may be validly imposed.
>
> In the imposition of penalties for the violation of its rules, Congress has a wide discretion. * * *
>
> In the instant case, the penalty attaches to the use of the instrumentalities of commerce and of the mails by those who, engaged in that use, refuse to submit to § 5 and thus through registration and the statement which is incident to registration to supply the information which Congress is entitled

> to demand, and has demanded, with respect to their organization and practices. * * * To escape the penalty and the enforcing provisions of the decree, all that the defendants have to do is to register with the Commission and assume, under § 5, the obligation to file the described registration statement."

The foregoing is, we believe, a sufficient background against which to pose the questions above presented. Without extended argument, we shall discuss them briefly in the order stated.

Argument

1. The Integrity and Enforcement of the Stipulation

It must be apparent that the plaintiff's complaint cuts athwart the public pronouncements of the Government enforcement officials, the stipulation embodying them, the position of counsel and the decision of the Courts in *Electric Bond and Share Company* v. *Securities and Exchange Commission, supra.* Section 4(a) prohibits unregistered public utility holding companies from "directly or indirectly" conducting any business at all, involving use of the mails or instrumentalities of commerce, and even from continuing to possess the securities of their regular subsidiaries. To hold that the promise of immunity pending determination of the constitutionality of the Act, extended by the responsible officers of the Government, still left the companies subject to avoidance and return of the consideration paid in substantially all business transactions which the holding companies might conduct through themselves or their subsidiaries during the period of test, robs it of its primary value. The monetary penalty for failure to register was the maximum fine of $200,000.

The civil penalty which the Circuit Court of Appeals here proposes to invoke, as applied to the instant case, is many times that amount, and, if extended throughout the gamut of the prohibitions of Section 4(a), the effect on countless transactions conducted in good faith might well be incalculable. Such a result, we think, is clearly made impossible by the decision of this Court in which Section 4(a) is treated solely as a penal and not as a regulatory provision, intended to coerce registration and nothing else. It is as much a penalty as a fine or a jail sentence and as such is enforcible by the Government and not at the suit of a citizen, regardless of his interest or lack of interest in the subject matter. The complaint here charges no damage or loss and does not propose to acknowledge or offset any benefits. It is purely to enforce the penalty as such.

2. The Right of Plaintiff Stockholder to Repudiate Company Action

The plaintiff sues as a stockholder of American Power & Light Company, one of the defendants to the test case in which the stipulation was made. The directors of the Company, on advice of counsel, as shown by the stipulation (Appendix, pp. 27, 28), had been advised to test the constitutionality of the statute. In view of these circumstances, any other course would have been a dereliction of duty. See *Hill* v. *Wallace,* 259 U. S. 44, 61 (1922); *Ashwander* v. *Tennessee Valley Authority,* 297 U. S. 288 (1936). In determining to test the Act, the directors had no choice but to refuse to register and seek the protection of an injunction against the imposition of penalties pending determination. Such an injunction was offered by the Government in *Landis* v. *North American Co.,* 299 U. S. 248, 252 (1936), and the stipulation here was equivalent to temporary injunction as this Court has held. *Na-*

tional Gas Pipeline Co. v. *Slattery,* 302 U. S. 300, 310 1937). This is confirmed by the final decree entered with the District Court on the mandate of this Court by consent of counsel for the Government.

This decree embodied by reference a further stipulation, dated March 31, 1938, between counsel for the Government and for defendants, that the stipulation in the cause was made "in order to avoid the necessity of multiplicity of suits, preliminary injunctions and procedural embarrassments," and that it was the intention of the parties through their counsel in framing the decree to allow the defendants time to register in an orderly manner after entry of judgment on the mandate, without incurring liability for contempt proceedings or "civil or criminal proceedings for violations of the Act committed before the termination of said period," and agreed "that there shall not be instituted civil or criminal proceedings against the defendants or any of them, or against their directors, officers, agents or employees or any of them, for any violation of the Act committed by them or any of them prior to the expiration of thirty days from the entry of said judgment upon said mandate" (Appendix, pp. 52-55).

The Government's complaint charged, among the violations of the statute in detail the existence and performance of service contracts by use of the mails and instrumentalities of commerce (Appendix, p. 39). These allegations were admitted by the answer, and it is specifically alleged that "such contracts and relationships are of value to the parties hereto and their termination would result in monetary losses and losses in economy and efficiency of operation" (*id.,* pp. 40-42). The existence and performance of such contracts are dwelt on at length in the decisions of the District Court, the Circuit Court of Appeals and the Supreme Court, as a principal ground of de-

cision. To have terminated these contracts, irrespective of the loss suffered thereby, would have abandoned one of the principal points upon which Court decision was desired by both the Government and the companies.

There is thus here presented the question whether a single minority stockholder may, under these circumstances, repudiate the formal action of the directors of his Company and sue for penalties which obviously the Company was itself estopped to seek. There is also presented the further question whether such a stockholder is not equally estopped, with the corporation party to such suit, thus collaterally to attack the findings of the District Court constituting an essential part of its decision in the test case, which in effect precludes the cause of action by declaring that the section of the statute upon which the action is based is without application (see p. 11, *supra*).

It is here held by the Circuit Court of Appeals, citing authority, that the suit may be maintained because of the control exercised by Electric Bond and Share over plaintiff's corporation (R. p. 110). But the authorities cited have to do with the remedy of wrongs suffered by the corporation which, by reason of the control, it is unable to remedy. Here there is no allegation of wrong but a bare allegation of statutory violation, in consequence of which it is sought to invoke the statutory penalty. The remedy given to stockholders in the cases cited is to redress violations of fiduciary duty by the directors of the controlled corporation. Here there was not a violation but a performance of that duty.

The importance of the litigation to American Power & Light Company may be indicated by the fact that it is presently under an order of dissolution made by the Securities and Exchange Commission and affirmed by the Cir-

cuit Court of Appeals for the First Circuit. See *American Power & Light Company* v. *Securities and Exchange Commission,* F. (2d) (C. C. A. 1st, March 17, 1944) (not yet officially reported). There can surely be no question that an effort to avoid such a result which was clearly envisaged by counsel and directors for the Company in determining to test the constitutionality of the Act was an act in good faith to conserve the interests of the Company and its stockholders and not in derogation thereof.

In these circumstances, we submit that the action of the directors in defending the Government's suit and entering into the stipulation was done in good faith in the interests of the Company. It must follow that stockholders, such as respondent, as well as the Company, are bound thereby.

3. The Application of the Doctrine of *Ex Parte Young*

It is well settled that a combination of civil and criminal penalties so extreme as effectually to destroy the entire business of a company, which in good faith seeks to test the constitutionality of a statute, may not constitutionally be applied during the period of such test. *Ex Parte Young,* 209 U. S. 123 (1908); *Missouri Pacific Railway Company* v. *Tucker,* 230 U. S. 340 (1913). This was conclusively recognized in the test case by the final decree on mandate entered by the District Court as above quoted. The penalties here sought to be invoked, while purely civil in nature, are clearly more drastic than criminal penalties and their application is completely destructive of the right of the Company recognized by the Government to test the statute.

As hereinbefore stated, a primary object of the promise of immunity held out by the Government enforcement officials to the industry and its embodiment in the stipula-

tion was to avoid the embarrassment of multiplicity of suits and preliminary injunctions and the possibility of incurring a partial and inconclusive determination of the case through the application of the doctrine of *Ex Parte Young*. The decision of the Court below in effect frustrates that intention by retroactively applying to the parties penalties which might otherwise have been avoided under the doctrine of that case by raising such questions expressly in the test case.

If this question be not deemed obviated by the stipulation in the test case, then the construction of the statute by the Court below under the circumstances of this case raises grave doubts as to its validity as so construed in the light of *Ex Parte Young*.

The Court below brushed aside these considerations on the "pragmatic" ground that the petitioners had actually challenged the constitutionality of the statute and obtained a final decision. That is plainly no answer, for defendants' attack and the consideration of this Court were based upon the stipulation which freed the Government of essentially extraneous obstructions to a consideration of the merits of the statute. Thus the stipulation and its meaning cannot be so casually disregarded. Moreover, this Court's decision of constitutional issues in the test case was expressly limited to Sections 4 and 5 (see p. 443 of 303 U. S.).

The parties and the Court in the test case clearly recognized the applicability otherwise of the doctrine of *Ex Parte Young* by including by stipulation in the final decree on mandate the equivalent of an injunction against the enforcement of penalties for past acts.

4. The Applicability Under These Circumstances of Section 26(b) of the Holding Company Act to Violations of Section 4(a)

Irrespective of other considerations and as a mere question of statutory construction, we submit that Section 26(b) of the Act is inapplicable to violations of Section 4(a). As herein previously stated, this was expressly held by Judge MACK in his findings in the test case, was expressly recognized by counsel for the Government, and is implicit in the decision of this Court as hereinbefore quoted.

Furthermore, although it was squarely presented in the briefs, the Circuit Court of Appeals does not consider, even to brush aside, the provision of Section 20(d) of the Act (15 U. S. C. A. 79t(d)), that no provision thereof

> "imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or order of the Commission, notwithstanding that such rule, regulation, or order may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason."

Clearly the published release of the Commission and its stipulation in the test case constituted formal action by it suspending the imposition of any liability under Section 26(b). If it were not otherwise clear from the whole tenor of the statute, this provision makes it clear that the enforcement of the Act as a regulatory measure and its interpretation, subject to review of the Courts, is vested in the Securities and Exchange Commission. While obviously civil rights and liabilities may arise from the statute or orders of the Commission thereunder, yet where the Commission rightly or wrongly interprets its powers so as to relieve any person from statutory penalties and the person

affected in good faith performs acts otherwise prohibited within the purview of such order, it is immune from such statutory liability.

That it is not the function of a stockholder's derivative action to vindicate public justice is well settled. *Venner* v. *N. Y. C. & H. R. R.*, 177 App. Div. 296 (2d Dept. 1917), aff'd, 226 N. Y. 583 (1919), cert. den., 249 U. S. 617 (1919). A private person, moreover, may not ordinarily assume the enforcement of a penalty statute. *City of New Rochelle* v. *Beckwith*, 268 N. Y. 315 (1935); compare *United States ex rel. Marcus* v. *Hess*, 317 U. S. 537 (1943). Accordingly, it would seem that Congress intended to leave to the Securities and Exchange Commission the enforcement of any penalties under the Public Utility Holding Company Act. The exercise of concurrent jurisdiction by the Courts at the instance of private parties to enforce penalties under the Holding Company Act would inevitably introduce confusion in the administration of that Act by the Securities and Exchange Commission. *Weinberger* v. *Semenenko*, 36 N. Y. Supp. (2d) 396, 405-6 (Sup. Ct. N. Y. Co., 1942) (no official citation).

5. The Application of Section 4(a) to a Subsidiary Service Company

The Circuit Court of Appeals held (R. pp. 109, 110) that since Section 4(a) makes it unlawful for unregistered holding companies to enter "directly or indirectly" into service contracts, and Section 27(a) makes it equally unlawful for any person to do anything through another which he could not do himself, the performance of service contracts by Ebasco Services was within the prohibitions of Section 4(a) and unlawful.

We submit that this construction of these sections of the Act ignores the inherent nature of the holding company

business and the structure of the Act, which recognized that nature and carefully distinguished throughout between holding companies and their subsidiaries and the prohibitions and regulations applicable to each.

While ordinarily statutory prohibitions may not be avoided through what the Chief Justice in *Electric Bond and Share Company* v. *Securities and Exchange Commission, supra,* termed "modal arrangements," this Act of necessity had to distinguish between holding companies and their subsidiaries in order to permit the electric power industry of the country to function. Consequently, the Act throughout separately defines a "holding company" (Section 2(a)(7)) and a "subsidiary company" (Section 2(a)(8)) and in various sections differentiates between the holding companies and subsidiaries as so defined and the prohibitions and regulations applicable to each. (See Sections 3, 6, 7, 8, 9, 11, 12(a), 12(b), 12(c), 12(d), 12(e), 12(f), 13, 15 and 17.) As particularly applicable here, Section 13 expressly differentiates between holding companies and subsidiaries in prohibiting absolutely the performance of any service contracts by holding companies, but expressly authorizing the performance of such contracts under regulation by the Commission by holding company subsidiaries.

Section 4(a) recognizes this differentiation in its specific prohibition by clauses 1 to 5, inclusive, which are directed solely against holding companies, and clause 6 which prohibits holding companies from owning the stock of subsidiaries which commit the prohibited acts. Both the District Court and the Circuit Court of Appeals in the *Electric Bond and Share Company* test case commented on this feature of the Act. Judge MACK, in the District Court, stated (18 F. Supp. 131 at p. 147) (Appendix, p. 47):

> "Paragraph (6) is an essential part of the regulations in the registration provisions, if the other paragraphs of section 4(a) are to have any appreciable effect. Without it, it is only necessary for any holding company to transfer its activities to its subsidiaries in order to escape the regulations. A good example of how this might be done is provided in the organization of Ebasco, and the transfer of its service contracts and facilities by Bond & Share to this 100 per cent. owned subsidiary."

And the Circuit Court of Appeals said (92 F. (2d) 580 at p. 591) (Appendix, p. 49):

> "By Section 4(a)(6) of the Act (15 U. S. C. A., Sec. 79(d)(a)(6), Congress has not attempted to disregard the corporate entity of any corporation. The provisions of the Act which regulate the relations between the holding company and its subsidiary take into full account the existence, separation, and protection of such entities. Congress has found that in certain situations the proper regulation of interstate commerce and postal activities of the subsidiary requires the regulation of the controlling company. 'It is with the system that the law must deal, not with its elements.' "

Any other construction would have been utterly destructive of the public utility industry. What was sought by Section 4(a) was to coerce holding companies to register. It did not attempt to prohibit their subsidiaries from functioning if their holding company should prove recalcitrant. Otherwise the entire electrical business of the country would have been paralyzed, as the use of the mails and other instrumentalities of interstate commerce would have been in effect prohibited to the entire industry in its most minute ramifications.

The Court's suggestion that Ebasco Services Incorporated was created "for the express purpose of contravening the Act" (R. pp. 109, 110) is purely gratuitous. The creation of this subsidiary was not only a recognition by Electric Bond and Share Company of the distinctions drawn by Section 4(a) itself but was also an essential step towards placing the companies in the Electric Bond and Share Company system in a position promptly to comply with the Act (specifically Section 13, which prohibits holding companies to perform services but permits subsidiaries to be formed for that purpose) in the event that the Act should finally be held constitutional. The decision of the Supreme Court in the test case was rendered on March 28, 1938, and on April 1st of that year the Companies registered and Ebasco Services was enabled to continue to function within the confines of the Act without interruption of business. This would have been impossible had Ebasco not been created.

Specification of Errors

The Circuit Court of Appeals erred in reversing and remanding the judgment of dismissal of the District Court and in holding that the first cause of action in plaintiff's complaint stated a claim or claims for relief.

Reasons Relied on for Allowance of the Writ

On the facts and argument hereinbefore stated, it is submitted that the writ should be granted. The issue presented is fundamentally one of the integrity of the judicial processes of the country and the protection of litigants in reliance upon the responsible officials of the Government in the prosecution and defense of litigation. Ampli-

fication of this statement would be mere repetition of what has been said before.

It must also be apparent that the questions presented are of prime and fundamental importance in the future administration of the judicial process. If the decision of the Circuit Court of Appeals be sustained, it is difficult to see how any citizen may challenge the constitutionality or applicability of statutes no matter how well founded the challenge may be if, regardless of the assurance of protection against penalties extended to him by injunction or stipulation of the Government, he must incur the risk of utterly destructive civil penalties in the event he is unsuccessful in the litigation.

It would be equally embarrassing to the enforcement officials of the Government in attempting to avoid, in situations of this kind, the procedural embarrassments of litigation having for its purpose the determination of novel and important questions, if litigants were no longer able to extend full faith and credit to their procedural stipulations.

For the information of this Court, the Supreme Court of the State of New York, County of New York, has reached an opposite conclusion from the Court below, *Weinberger* v. *Semenenko,* 36 N. Y. Supp. (2d) 396 (Sup. Ct., N. Y. Co., 1942) (no official citation). This decision was followed by the Supreme Court of the State of New York, Kings County, in *Shanik* v. *Aller* (N. Y. Sup. Ct., Kings Co., Oct. 1, 1942) (no reported decision). In addition, as shown above, the decision of the Court below as to the application of Section 26 is in direct conflict with the decision of this Court in the test case and is probably in conflict with the other decisions of this Court cited above. The precise questions presented by this case have not been, but should be, settled by this Court.

Conclusion

WHEREFORE petitioners respectfully pray that a writ of certiorari be issued to the United States Circuit Court of Appeals for the Second Circuit in accordance with the practice of this Court and that a hearing upon and determination by this Court of the matters presented be had.

Dated: May 26, 1944.

Respectfully submitted,

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